

An operator of 'TOMAS' private classes for students preparing for higher education

Recommendation rating (Nov 18)

Riso Kyoiku Co., Ltd. (4714-TSE)**Overweight**

Stock Price	Unit of Investment	Market Cap	52-Week High	52-Week Low	PER (E)
583yen (11/18)	100Shares	303.6Bil yen (11/18)	605yen (16/10/31)	274yen (16/2/12)	24.2 (11/18)

Riso Kyoiku accelerates opening new schools; entering a new stage of making great strides

■ 2Q FY2016 saw growth in both revenue and profit, driven partially by contribution from new businesses

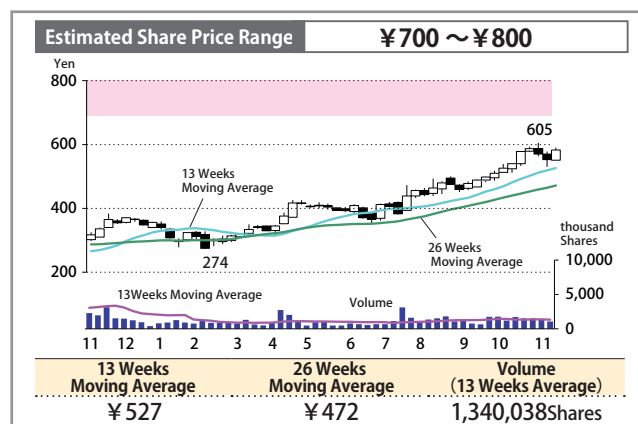
For the six months of fiscal year ending February 2017 (March – August 2016), Riso Kyoiku Co., Ltd. posted revenue of 9,964 million yen, up 5.6% compared with the same period last year and operating income of 734 million yen, up 8.4%. **The percentage achievements against full-year targets at the end of the second quarter of fiscal 2016 were 47.9% for revenue and 35.0% for operating income. Given the nature of the company's business, with earnings in the second half of the fiscal year disproportionately larger compared with the first half, we may see that Riso is on track to surpass its full-year targets.**

In the first six months of fiscal 2016, it continued to post solid revenue growth across all segments on a year-on-year basis, with its core Cram School segment achieving a 7.2% increase, while the Early Childhood Education and In-School Tutorials segments logged 9.2% and 6.3% growth, respectively. From this quarter ended September 30, 2016, its core TOMAS business (cram schools that provide completely one-to-one tutorials to students preparing for higher education) has resumed a new school opening program. In March, it opened the Yotsuya school, followed by the Tamachi school in June. The Meimonkai business (consisting of professional tutors only) showed solid earnings, due largely to the contribution from a newly established Kanazawa branch, its first branch in the Hokuriku District. On the new business front, the School TOMAS business, the operator of one-to-one TOMAS classrooms within ordinary school buildings and the Shinga's Club, extended-hours nurseries aiming to develop the ability of pre-school children, continued to post better-than-expected performances.

Riso has promised to deliver a 100% shareholder return for this fiscal year. In line with this commitment, it announced that it would raise the dividend by 6.0 yen per share for the third quarter and fourth quarter. Previously, it planned to pay a full-year dividend of 8.0 yen per share. This will result in a sharp increase in the full-year dividend for fiscal 2016 to Yen 24.0 per share (compared with previously projected interim and year-end dividends of 10.0 yen and 20.0 yen respectively).

■ TOMAS accelerates opening new schools

Riso's medium-term management plan (ends in fiscal 2018, ending February 2019) has set targets for the plan's final year on revenue and ordinary income at 23,800 million yen (up 7.2% from the previous fiscal year) and 2,800 million yen (up 16.7%) respectively. The success in the achievement of these targets relies in large part on the performance of its mainstay cram school business. Currently, the TOMAS business operates tutorials at a total of 67 schoolrooms in Tokyo and another three prefectures; the number of schoolrooms is far lower than that operated by its competitors. This shows that there is substantial scope for Riso to open further cramming classes in the Tokyo metropolitan area. The company has embarked on a 'satellite cram school strategy', in which it will open schoolrooms relatively



smaller than conventional sized ones in a convenient location, such as near a train station. Through this strategy, it plans to double the number of schoolrooms to approximately 120. On October 21, it announced the opening of "TOMAS Togoshi" (Shinagawa Ward) in March 2017. This will be its third newly opened school. Riso is expected to take on an all-out implementation of the satellite cram school strategy from the next fiscal year, extending the number of schools incrementally to 10 new schools each year. **Meanwhile, with regard to the development of areas with no TOMAS schools, the company has already mapped out a plan to deploy the Meimonkai business model. Currently it runs a total of 28 Meimonkai schools in large cities with a particular emphasis on ordinance-designated cities. Under the plan, the Meimonkai business will take the initiative of developing these areas by extending "TOMAS Meimonkai" (tentative name) schools.** Going forward, the company plans to increase the number of TOMAS Meimonkai schools to around 150, by opening 2 – 3 schools in each prefecture.

The Shinga's Club comprises classes that provide early learning programs to nurture pre-school children aged one to three. It is a burgeoning business that has shown a solid performance over the recent months. There is mounting public concern about long lists of pre-school children who are waiting for admittance to nurseries. Hence, the Shinga's Club is expected to be a solution to the problem. Currently, the Club operates a total of six schools, principally in the Tokyo Metropolitan area. Its schools are in high demand, therefore it plans to rapidly establish more schools to cope with the excessive number of applicants on the waiting list for next term's enrollment. **We now predict that each business will speedily open more new schools in the coming years, moving forward to position themselves for rapid progress.**

We made no major changes to our five-year earnings forecast, produced based on the company's projections. We plan to leave our fair value estimate for Riso's shares unchanged, in the range of 700

Revenue and Earnings Trend (As of November 18)

		Revenue (Yen Mil)	YoY (%)	Operating Profit (Yen Mil)	YoY (%)	Ordinary Profit (Yen Mil)	YoY (%)	Net Profit (Yen Mil)	YoY (%)	EPS (Yen)
2015-2	Past Results	18,776	-5.1	1,006	▲298.0	978	▲284.5	2,379	▲188.7	47.8
2016-2	Past Results	19,643	4.6	1,890	87.9	1,857	89.9	1,428	▲40.0	27.7
2017-2	Company est.	20,800	5.9	2,100	11.1	2,050	10.4	1,250	▲12.5	24.1
	MS est.	20,800	5.9	2,100	11.1	2,050	10.4	1,250	▲12.5	24.0
2018-2	MS est.	22,500	8.2	2,500	19.0	2,550	24.4	1,555	24.4	29.9

— 800 yen, calculated based on our five-year forecast using the DCF (Discounted Cash Flow) method. Share prices have gone up since the issue of our previous report (dated on August 10), in positive response to the company's new business strategy and dividend increase announcement. Nevertheless, the share price still has ample potential to rise further relative to our estimated share prices, therefore we maintain our valuation of the company shares with an 'Overweight'. In addition, we note the estimated dividend yield for this fiscal year jumped to an attractive 4.1% (based on the closing price on November 18), in the wake of the announcement of dividend increases.

(Hiroyuki Miyamoto)

Company Overview

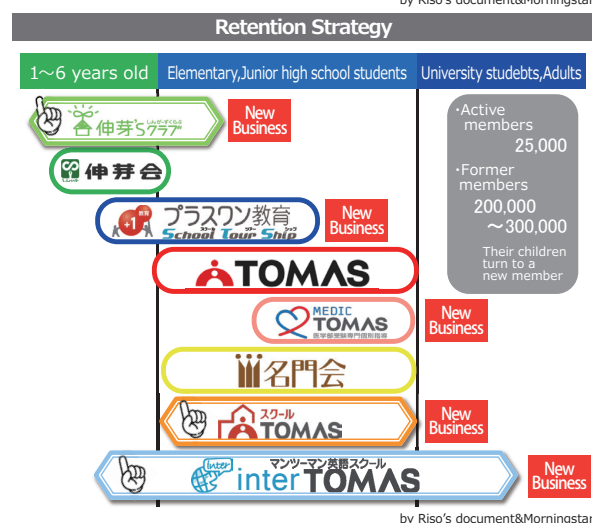
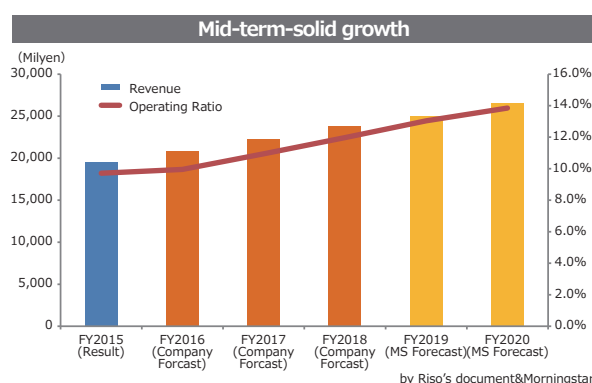
Riso Kyoiku Co., Ltd. is an operator of 'TOMAS', private tutorial-based cram schools primarily in the Tokyo Metropolitan area, for children preparing for higher education. Traditionally, tutorial lessons were largely seen as an opportunity to receive supplementary education. However, Riso, for the first time in the industry, targeted children aspiring to 'higher-level education'. Because of this, its schools have demonstrated high-level advancement rates. While tutorial lessons at cram schools operated by other companies often take the form of 'one tutor to a few students', Riso's lessons are strictly on a one tutor to one student basis. For this reason, its programs require relatively high monthly tuition fees. In return, its students can receive higher-quality education programs from proficient tutors who have completed the company's intensive training courses and choose lessons that meet their specific requirements from 'various curricula' among other distinctive services.

As of the end of August 2016, Riso were operating 67 TOMAS schools. They had fewer classrooms compared with competitors, but this suggests that there is plenty of room for the company to open new classrooms. Going forward, the current number of TOMAS schools is expected to double to reach approximately 120. In addition to TOMAS, other major businesses include Meimonkai (14 branches with 27 schools), tutoring centers that specialize in dispatching professional tutors and the Shingakai (24 classrooms) which the company acquired (M&A) in 2013. Under its medium-term management plan, Riso focuses its management resources on the expansion of newly established businesses, including the Shinga's Club, a nursery chain aiming to develop the ability of pre-school children (aged 1+), School TOMAS, an operator of TOMAS classes within school buildings and Inter TOMAS that provides one-to-one English lessons not only for children but college students and business people as well. The company also promotes a strategy to 'retain customers' by extending its target demographic from one-year-old toddlers to adults.

Business Environment and Outlook

According to the Vital Population Statistics issued by Japan's Ministry of Health, Labour and Welfare, in 2015 there were 1,008,000 newborn babies, 15% fewer than those registered in 2000. Meanwhile, the Family Income and Expenditure Survey of the country's Ministry of Internal Affairs and Communications showed that complementary education expenses as a percentage of total education expenses in 2015 stood at 23.4%, a modest increase on the 22.6% logged in 2000, indicating that education expenses per head were on an upward trend.

Riso's tutoring programs completely comprise lessons on a one tutor to one student basis. The company takes the view that the cram school business belongs to the service sector not the education; therefore it makes thoroughgoing efforts to constantly improve its service quality. Although it charges relatively higher service prices, its one-on-one lessons provide significantly higher-quality service compared with group teaching and one-tutor for multi-student programs. There



is a growing trend among cram school users to seek higher-level education services as such those offered by the company. Riso's tutors receive comparatively higher salaries than others. This has helped the company to recruit highly competent tutors. It also implements rigorous training programs for employees and tutors. Employees in the classroom are assigned to full-time tutoring jobs, which allow them to concentrate on their lessons.

Risk Factors

Riso plans to increase TOMAS classrooms by opening new schools in locations with a focus on the Tokyo metropolitan area, as well as expanding or renovating existing schools; however, the number of classrooms may not be able to increase according to plan if the company faces difficulties in securing properties. In addition, Mr. Mitsugu Iwasa, the founder, director and corporate advisor to Riso, has led the company's management for a long period of time, significantly contributing to the company's 28 consecutive fiscal years of revenue growth. Therefore, the possibility that Mr. Iwasa became unable to engage in company management for any reason would pose a threat to its smooth operation.

Shareholder Return (As of November 18)

Dividends

		Dividend Per Share		
		First half	Second half	Annual
2015-2	Past Results	¥0	¥0	¥0
2016-2	Past Results	¥0	¥10	¥10
2017-2	Company est.	¥12	※ ¥12	¥24

※ Changed dividend as of August 19

Shareholder Special Benefits

None

Competitor Comparison (If the number is better than rivals, it's highlighted by red character) (As of November 18)

	Riso Kyoiku Co., Ltd. (4714•TSE 1st)	MEIKO NETWORK JAPAN CO.,LTD. (4668•TSE 1st)	Tokyo Individualized Educational Institute, INC. (4745•TSE 1st)	
Stock Price	¥ 583	¥ 985	¥ 589	
Basic Point	Unit of Investment	100Shares	100Shares	100Shares
	Minimum Investment Amount	¥ 58,300	¥ 98,500	¥ 58,900
	Fiscal Year End	February	August	February
Share Price Indicator	PER (E)	24.2倍	17.3倍	20.9倍
	PBR	3.9倍	2.0倍	3.9倍
	Dividend Yield (E)	4.1%	4.1%	4.4%
Growth	Revenue Growth Rate (E)	5.9%	7.3%	5.3%
	Operating Profit Growth Rate (E)	11.1%	17.7%	8.3%
	EPS Growth Rate (E)	▲13.1%	61.3%	10.8%
Profitability	Operating Margin (E)	10.1%	12.8%	13.3%
	ROE	20.7%	6.8%	17.5%
	ROA (Ordinary income/Total assets)	15.1%	13.0%	21.9%
Financial Health	Equity ratio	62.3%	77.4%	78.5%
	Debt-Equity Ratio	0.0%	0.6%	0.0%
	Current Ratio	210.2%	224.4%	365.6%

Our chosen industry peers are MEIKO NEYWORK JAPAN (4668), an operator of "MEIKOGIJYUKU". We also pick up Tokyo Individualized Education Institute (4745), known as a group company of Benesse.

※ August 19, Riso announced that would pay dividend 12.0 yen (6.0 yen at 3Q, 6.0 yen at 4Q) for the second half of the year

■ Growth

Riso provides high-quality education services that demonstrate strong resistance to lower birthrates, therefore the Company is expected to achieve steady growth in the face of difficult business conditions. Under its medium-term management plan, in fiscal 2018 ending February 2019 --- the final year for the plan, Riso aims to achieve the goal for revenue of 23,800 million yen and ordinary income of 2,800 million yen. Meanwhile, as its long-term goal, by fiscal 2021 ending February 2022, the company intends to post revenue of 40,000 million yen or more, double the amount of its projected revenue for fiscal 2016, and ordinary income of not less than 5,000 million - 6,000 million yen. However, the company has a policy not to implement a far-fetched new school opening plan, thereby aiming to achieve a steady high-single-digit rate of revenue growth over the next three years. Contrary to the moderate revenue growth, the company is likely to maintain a high-level and double-digit rate of profit growth, as it rolls out an expansion in profitable new business operations. From fiscal 2019 ending February 2020, when contributions to its earnings from new businesses are set to gain momentum, the company's bottom lines are expected to exhibit remarkable growth.

■ Profitability

In the past, Riso was acclaimed for delivering high ROEs (returns on equity). With the resolution of the irregular accounting issue, it now expects to resume a policy of placing emphasis on ROEs. The ROE for fiscal 2015 stood at 20.7%, which already outnumbered that of its competitors. Going forward, Riso's ROE is likely to increase, supported by solid contributions from the School Thomas and other highly profitable new businesses.

Riso Kyoiku indicated its adoption of a policy of attaching importance to returning 100% of net profits to shareholders and employees; therefore profit growth is highly likely to lead to a dividend increase among other returns.

■ Financial Health

Riso's equity ratio at the end of fiscal 2015 was 62.3%, up from 50.1% at the end of the previous fiscal year. With no interest-bearing debts, the company essentially manages its operations without relying on borrowings. It uses all schoolrooms on lease and the nature of the industry in which it is involved does not require major capital expenditure. The School TOMAS business builds a classroom at its own expense if it is unable to locate to one within a school building; however this seems to be very exceptional. In light of these factors, together with its liquidity ratio exceeding 200%, there is little concern about the company's financial standing.

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How to Read Morningstar Equity Research Report

Our Uniqueness

(1) Emphasize Its Position as an Independent Evaluation Organization

Morningstar emphasizes its position as an independent evaluation organization and is committed to providing objective comparison and assessment in the Morningstar Equity Research Report. For all stocks covered by us, we determine investment decisions, estimated share price range and earnings forecasts based on expertise of an individual analyst as well as the stock assessment committee consisting of several analysts.

(2) Universe of Covered Stocks

The stock assessment committee selects covered stocks based on the following criteria.

[Stock Selection Criteria]

- Domestic emerging companies that are rarely covered by analysts
- Stocks that are popular among retail investors (refer to data from online security brokers)
- Size of market capitalization (over about 5 billion yen)
- Exclude stocks which are liquidated or trade control, or stocks with going concern and excessive debt

(3) Investment Decisions Classified into Three Groups

We determine investment decisions for covered stocks after consultation with the stock assessment committee based on research, interview and analysis by each Morningstar analyst.

Each stock is classified into either of three groups according to the following criteria.

Overweight : Forecasted to go beyond the current stock price level by 15% or more in the next 6 months.

Neutral : Forecasted to fall into the range of -15% ~+15% of the current stock price level in the next 6 months.

Underweight : Forecasted to go below the current stock price level by 15% or more in the next 6 months.

We flexibly respond to any changes of observations regarding earnings forecasts, financial situations and stock price trends, and change investment decisions accordingly. "Under Review" status may be applied if any new information comes out and extra time is needed to determine investment decisions. Also we don't change investment decisions during trading hours. "Suspension" status may be applied when an analyst leaves our company.

(4) Estimated Share Price Range in the Medium Term

It shows the price range for a stock price in the next 6 months. We determine upper and lower range of stock price based on fair value estimates from share price indicator, technical factors such as chart points, most recent high and low prices, trend line and moving average, trading volume in each price range and such.

Analysis Points

■ Analyst Comment

Each analyst reports and evaluates the most recent earnings trend and business environment. It shows the most important information for stock investment such as evidence for investment decisions, perspectives on earnings forecasts and business prospects. Also to make sure it is easy to comprehend, we write in 2-4 paragraphs and use bold to emphasize important texts.

■ Revenue and Earnings Trend

It reports earnings in past two fiscal years, company forecasts and our forecasts for the current and next fiscal year. We predict earnings based on research as well as past quarterly earnings trend and analysis by segments.

■ Company Overview

It explains in detail what businesses the company is engaged in and how revenue sources are defined. Also on the basis of our research, it discusses what businesses the company will focus on in years to come and how it carries out mid-term business plan.

■ Business Environment and Outlook

It discusses current circumstances and growth potential of the industry to which the company belongs. A comprehensive report on the industry from different perspectives is provided through research interviews to competitors. Specific figures of the industry data are also introduced.

■ Risk factors

It shows the company's risk factors and describes various aspects of risks such as business, earnings and financials. Typical stock market risks are also taken into consideration.